

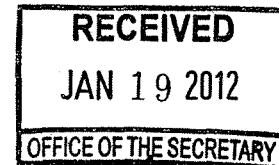
ORIGINAL

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3273 / September 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14536

HARD COPY



In the Matter of

MONTFORD AND COMPANY,
INC. d/b/a MONTFORD
ASSOCIATES,

and

ERNEST V. MONTFORD, SR.,

Respondents.

Respondents' Post Hearing Brief

Respondents' Post Hearing Brief

Pursuant to Rule of Practice 340, Ernest V. Montford and Montford and Company, Inc. (collectively "Montford" or "Respondents") respectfully submit their Post Hearing Brief.

I. FACTS

Montford has filed herewith detailed Proposed Findings of Fact, with citations to the record, which should be reviewed in connection with this Brief. The facts will not be restated except as they relate to specific arguments in the discussion below.

II. ARGUMENT

A. The Case Should be Dismissed Because Division did not Comply with the Dodd-Frank 180 day Rule

The threshold question in this case is whether both parties must comply with the letter of the law, or only Montford.

Montford renews its motion to dismiss the case because of Division's failure to comply with 180 day filing requirement of Section 929U of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), 15 U.S.C. § 78d-5. As the factual record is now closed, there can be no dispute that Division has not and cannot show compliance with the law. This Court denied this relief in an order dated October 5, and also denied reconsideration. Montford urges the Court to reconsider the issue once again.

As this Court is aware, Dodd-Frank sets a statutory "[d]eadline for completing enforcement investigations" (the "Dodd-Frank Deadline"):

Not later than 180 days after the date on which Commission staff provide a written Wells notification to any person, the Commission staff *shall either* file an action against such person or provide notice to the Director of the Division of Enforcement of its intent to not file an action.

15 U.S.C. § 78d-5(a)(1) (emphasis added). If the Director of Enforcement determines that the investigation is "sufficiently complex," the Director of Enforcement may grant a 180-day extension of time within which to file an action. 15 U.S.C. § 78d-5(a)(2).

The Atlanta Regional Office issued a Wells Notice to Respondents on March 4, 2011. Under Dodd-Frank, Commission Staff had 180 days, until August 31, 2011, to file an action. This action was not filed until September 7 – seven days late. Since the action was not filed within the Dodd-Frank Deadline, Respondents on September 8 filed a Motion to Dismiss. In response, Commission Staff conceded that the deadline was

missed, but made two arguments against dismissal. First, Commission Staff argued that the statutory deadline for filing an action or dismissing the case was not enforceable by Respondents. Second, Commission Staff argued that, even if the Dodd-Frank Deadline was, in fact, a “deadline,” (which is what Congress calls it), Commission Staff met the deadline by obtaining a ten-day extension from the Director of Enforcement. Dodd-Frank, however, does not give the Director of Enforcement the blanket authority to give Commission Staff an extension. Instead, Dodd-Frank requires that the Director of Enforcement, or his or her designee, determine that the particular investigation is “sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed” within the 180-day deadline. 15 U.S.C. § 78d-5(a)(2). Commission Staff did not even allege, much less present any evidence, that the Director of Enforcement made the determination required by Dodd-Frank.

It is critical to be very clear on these undisputed facts. This is not a case in which Commission staff has taken the position that the Director of Enforcement made the complexity determination. *Commission Staff has never represented, in briefs or in the hearing before the Court, that the Director of Enforcement actually made the determination that Dodd-Frank requires.* This is also not a case in which the Director of Enforcement has in fact made the complexity determination, and the issue is whether and to what extent the Court must defer to that determination. There is no evidence and, remarkably, no contention by Division that the Director of Enforcement made the determination that the investigation is “sufficiently complex such that a determination regarding the filing of an action against a person cannot be completed” within the 180-day deadline. 15 U.S.C. § 78d-5(a)(2).

On October 5, 2011, this Court denied the Motion to Dismiss and rejected Respondents' argument that Dodd-Frank required the Director of Enforcement to make the determination of the complexity of the investigation. Your Honor's analysis is contained in the following sentence: "the complex nature of the proceeding is demonstrated by the fact that the Commission directed that an Initial Decision be issued within 300 days, the time allowed for deciding the most complex proceeding" under 17 C.F.R. § 201.360.¹ No other fact or law was cited in support of the holding that the extension had been obtained in compliance with Dodd-Frank.

The Commission's selection of a 300-day schedule under Rule 360 was not an argument that was advanced by Division in its briefs or at the hearing; it was instead articulated for this first time in this Court's October 5, 2011 Order. Respondents note that Division, despite being given a perfect opportunity to do so, refused to embrace or support the Court's analysis. As explained below, the Court's holding is incorrect as a matter of law and will have the unintended consequence of confounding the application of both the Dodd-Frank Deadline and the 120/210/300-day guidelines under the S.E.C. Rules of Practice ("the Rule 360 Guidelines").

1. The October 5, 2011 Order confuses two separate deadlines: the Dodd-Frank Deadline, which addresses the time period from the issuance of the Wells Notice to the initiation of an action, and the Rule 360 Guidelines, which addresses the next time period, from the initiation of the action through the issuance of the Initial Decision. In its October 5, 2011 Order denying the Motion to Dismiss, the Court equates the Rule

¹ The October 5, 2011 Order actually cites to 17 C.F.R. § 320, but that section deals with evidence. Respondents have assumed that the Court intended to cite to 17 C.F.R. § 360, which addresses the 120, 210 and 300-day time limits for the issuance of an Initial Decision.

360 Guidelines with the Dodd-Frank Deadline, but the two standards are not nearly the same. Under the Rule 360 Guidelines, the Commission has the authority to specify one of three time periods (120, 210 or 300 days) running from the date of the issuance of the Order Instituting Proceedings until the issuance of the Court's Initial Decision. The Commission is to make this determination "after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors." Significantly, "complexity" is only one of the factors. The decision to specify a 300-day deadline could be made in a case that is *not* complex, particularly if the matter is not urgent and the longer period is in the public interest. Conversely, the Commission clearly has the discretion to specify a 120-day deadline in a very complex case if, for example, the matter is urgent and a quick decision is in the public interest. Obviously, the Commission's selection of the 300-day time period cannot, by any stretch of reasoning, be equated with a Commission finding that the matter is complex.

2. Dodd-Frank and Rule 360 address two entirely different phases of a case. Under the extension provisions of Dodd-Frank, the complexity determination relates to the "particular enforcement *investigation*" – a process that culminates in the filing of an action. Rule 360, on the other hand, picks up where the Dodd-Frank Deadline leaves off, and governs the time period running from the filing of an action until the Initial Decision. In many cases, a complex investigation could also mean a complex trial schedule, but in many cases a relatively straightforward investigation, *i.e.*, one that was not sufficiently complex under Dodd-Frank to warrant an extension of the 180-day deadline, could be followed by a complex hearing warranting a relatively long 300-day post-filing process. The reverse is also true: a complex investigation could culminate in

an Order Instituting Proceedings in which the Commission determined that, because the facts of the case were straightforward or because the matter was urgent, a 120-day deadline for the issuance of the Initial Decision was in the public interest. The point is this: it is a clear mistake of law to apply the Commission's finding under Rule 360 to an entirely different issue under Dodd-Frank.

3. Dodd-Frank requires the complexity determination to be made by the Director of Enforcement, not the Commission itself. Congress might have written Dodd-Frank differently and given to the Commission the responsibility for assessing the complexity of a particular investigation – an odd delegation of day-to-day responsibility, to be sure. But Congress plainly (and sensibly) did not do so, delegating instead that responsibility to the Director of Enforcement. Thus, even if the Commission had decided that the matter was complex (it did not), and even if that decision applied to the investigation (it did not), there was no proper extension in this case under Dodd-Frank because the determination of complexity was not made by the Director of Enforcement.

4. The Court's conflation of the Rule 360 Guidelines and the Dodd-Frank determinations will have unintended consequences for the Commission. If the Commission's specification of a 300-day period under Rule 360 is the same as a finding that the investigation is complex (which is what the Court has ruled in this case), then the specification of a 120-day period under Rule 360 must mean that the investigation is *not* complex and that any prior extension taken under Dodd-Frank was improper. This is an absurd result, of course, but one required by the Court's decision. Or, if in a particular case the Director of Enforcement has determined that the investigation is complex and that an extension is warranted under Dodd-Frank, then the Commission in deciding between 120, 210 and 300 days *must* select 300 days, no matter how urgent

the case, since the selection of a shorter period would be inconsistent with, and thereby invalidate, the prior extension. Again, an absurd result, but a necessary application of the Court's reasoning.

The case should therefore be dismissed.

B. The Division Misstates the Law on Conflicts of Interest -- There is No Section 206 Violation

Montford did not violate Section 206 because the payments Montford received from SJK were not "fees" and did not, as a matter of fact and as a matter of law, cause or reflect any conflict of interest.

The Division's Section 206 argument is based upon a misstatement of the law and flawed circular reasoning. The Division's flawed analysis begins on pages 21 and 22 of its Brief. After citing long passages from *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), Division concludes: "Accordingly, any financial benefit to the advisor apart from advisory fees presents a conflict – irrespective of why the benefit was purportedly conferred – because such a financial incentive tends to taint the advisor's objectivity and judgment." *Capital Gains* holds no such thing: "why the benefit" was conferred is the critical question. In the passage quoted by Division on page 21, the Supreme Court in *Capital Gains* expressed concern "whenever advice to a client might result in financial benefit to the adviser – other than the fee for his advice." Thus, the concern is the relationship between the advice to the client and the financial benefit. Certainly, if an investment advisor has a financial incentive to offer certain advice, under *Capital Gains* there is an actionable conflict of interest and potential violation of Section 206. But the key question is if "advice to a client might result in financial benefit to the advisor – other than for the fee for his advice." If the advice to the client

does *not* result in financial benefit to the advisor, other than for the fee for his advice, then there is no conflict of interest, no violation of law, and no material information to disclose.

In this case, there is no evidence, none at all, that Montford's advice to his clients to invest in SJK (or, in some instances, to not invest in SJK), resulted in financial benefit or detriment to Montford. Montford testified to the contrary, repeatedly, and there was no contrary testimony. Division, for its own reasons, made the tactical decision to not call the only other person who would know whether Montford was paid to direct clients to SJK – SJK himself. There is no documentary evidence, or any calculations, or any tabulations or any other kind of evidence that would have to have been generated by either Montford or SJK if the payments by SJK were based upon the number of clients Montford steered to SJK. On the most important factual issue in the case – whether Montford had a financial incentive to steer clients to SJK – the Division presented no direct evidence, much less enough evidence, to meet its burden of proof. Division not only could have called SJK to testify, but also could have called any number of SJK's employees, who would have known of any such a deal (and, facing indictment, would have been eager to testify to please the S.E.C.). But Division did not call any witnesses to prove this critical piece of its case. Indeed, Division's factual presentation on this issue was so weak it is clear that Division believed that it only needed to show payment (which was conceded), and that did not need to show that the payment was to compensate Montford for steering clients to SJK.

In addition, there was substantial evidence corroborating Montford's testimony. One can imagine a case in which an investment advisor steered clients to a particularly bogus investment; in such an instance, an inference may be drawn that the advisor had

an ulterior motive for doing so. Here the exact opposite inference must be drawn. For all anyone knew (including the S.E.C., which had SJK under a microscope at the time), SJK's funds were a very sound investment. Montford testified that he recommended SJK because of SJK's performance, and that testimony is totally plausible given the legitimate gains that SJK had posted over the years. Further, there is no evidence that the fact of the payment changed Montford's actions. Montford testified, and the record evidence confirms, that Montford recommended that his clients invest in SJK before, during, and after Montford received payment from SJK. SJK's payment was not for, and had no impact upon, Montford's advice.

It is true that *if* there is a conflict of interest, such as one caused by receiving additional payment to steer clients to a particular manager, *then* the S.E.C. does not need to prove that an investment advisor actually yielded to that conflict and gave tainted advice. But there has to be a conflict of interest in the first place, and there is no conflict of interest if, as here, the investment advisor was paid the same (by SJK and his clients) no matter where his clients invested the money.

It also is true that *if* there is a conflict of interests or even potential conflicts of interest, then those conflicts are material and should be disclosed to investors. Since Montford was not (potentially or actually) going to be paid more to steer clients to SJK, there was no potential or actual conflict of interest and no duty to make any additional disclosures.

It also is true that *if* there is a conflict of interest, the investment advisor's good-faith or honesty also is irrelevant. Montford does not contend otherwise. Instead, the evidence showed that there was no conflict of interest.

Montford urges the Court to consider carefully the *Capital Gains* case itself, upon which Division relies so heavily. Here is how Justice Goldberg frames the issue in the case:

We are called upon in this case to decide whether under the Investment Advisers Act of 1940 the Securities and Exchange Commission may obtain an injunction compelling a registered investment adviser to disclose to his clients a practice of purchasing shares of a security for his own account shortly before recommending that security for long-term investment and then immediately selling the shares at a profit upon the rise in the market price following the recommendation. The answer to this question turns on whether the practice—known in the trade as 'scalping'—'operates as a fraud or deceit upon any client or prospective client' within the meaning of the Act. We hold that it does and that the Commission may 'enforce compliance' with the Act by obtaining an injunction requiring the adviser to make full disclosure of the practice to his clients.

375 U.S. at 182. *Capital Gains* dealt with scalping, a practice that clearly gives an investment advisor an ulterior motive in recommending a particular security to a client – a motive that is contrary to the advisor's obligation to remain independent and, for that reason, clearly is actionable regardless of subjective honesty and good faith. For the holding in *Capital Gains* to apply to this case, the Division was obligated to show that advising clients to move to SJK would result in Montford receiving payment from SJK. As Justice Goldberg stated, the key issue is whether "advice to a client might result in financial benefit to the advisor – other than the fee for his advice." 375 U.S. at 187. Division, not believing that it needed to prove the connection between the advice and the payment, presented no evidence in support of this critical element.

The Division failed to carry its burden under Section 206 and *Capital Gains*.

C. There was no Section 207 Violation because the Economic Benefits Received from SJK were not “in connection with giving advice to clients”

Division contends that Montford violated Section 207 by failing to disclose on its Form ADV the fact of the payments from SJK. Here again, Division does not address the critical issue. The Form ADV required disclosure of economic benefit “from a non-client *in connection with giving advice to clients.*” There was no evidence that the payments from SJK were made in connection with Montford giving advice to any clients. Similarly, Montford’s statement that it did not accept “fees” from managers in the Form ADV was meant in the same way as the Form ADV question – an economic benefit in connection with giving advice to clients – such as a finder’s fee or a commission.

D. Relief Sought

Because the case should be dismissed under Dodd-Frank, and because Division has failed to carry its burden of proof on liability, no relief should be awarded in this case. In the event some relief is deemed by the Court to be warranted, Montford offers the following:

1. Isolated Infraction at Worst

If Montford did violate the law, it was an isolated infraction. Montford has a long and spotless record and, under the cases, that must be taken into account. *Monetta Financial Serv., Inc. v. S.E.C.*, 390 F.3d 952, 957 (7th Cir. 2004) (vacating Commission’s order imposing sanctions because the Commission failed to consider, *inter alia*, the isolated nature of the violation). Courts and the Commission have emphasized the importance of the advisor’s state of mind. *Steadman v. S.E.C.*, 603 F.2d 1126 (5th Cir. 1979). As Judge Tjoflat noted in *Steadman*: “It would be a gross abuse of discretion to

bar an investment adviser from the industry on the basis of isolated negligent violations.” 603 F.2d at 1141. Here, Montford did not know of the SJK fraud, did nothing to advance any of the fraudulent schemes, did not benefit from the fraud, and did not have any incentive to deceive its clients into investing in SJK. If Ernie Montford did not believe in SJK, Ernie Montford would never have invested his entire retirement account with SJK. Montford had no intent to harm anyone. *See S.E.C. v. Slocum, Gordon, & Co.*, 334 F.Supp.2d 144, 185, 187 (D. R. I. 2004) (for “non-scienter based, technical violations” refused to impose injunctive relief, instead imposed \$3,000 civil penalty).

In addition, Mr. Montford has paid dearly. At 64, he has lost his retirement funds and, most important, lost his business. He has paid one client \$40,000 in settlement already, and paid well over a hundred thousand dollars in legal fees. There is no need to punish Mr. Montford further.

2. Cease and Desist Order Unnecessary and Unlawful

A cease and desist order is unnecessary, unwarranted, and, in this Circuit, unlawful. It is unnecessary because Division made no credible showing of “some cognizable danger of recurrent violation.” *Slocum*, 334 F.Supp.2d 144 at 185. No one who attended the hearing could reasonably believe that Montford will ever either accept another fee from a manager.

A cease and desist order would also be unwarranted. The “cease” portion of such an order constitutes an implied representation by the Court that a violation is ongoing. There is no evidence that that is the case; indeed, the Division does not contend that there is any ongoing violation. Hence, an order directing Montford to “cease” its violation of law is deceptive and unjust.

A cease and desist order that simply commands Montford to obey the law is unlawful in this Circuit, as the SEC is well aware. *SEC v. Smyth*, 420 F.3d 1225 (11th Cir. 2005). "This circuit has held repeatedly that 'obey the law' injunctions are unenforceable." *Id.* n.14. It is black-letter law that an injunction that commands a party to simply "obey the law" may not be enforced by contempt. In *Burton v. City of Belle Glade*, 178 F.3d 1175, 2000 (11th Cir. 1999), the Eleventh Circuit affirmed a district court's refusal to enjoin the City from discriminating on the basis of race because such an injunction would be invalid under the specificity requirements of Rule 65 and established Eleventh Circuit precedent. The Court reasoned:

Appellants seek to enjoin the City from discriminating on the basis of race in its annexation decisions. As this injunction would do no more than instruct the City to "obey the law," we believe that it would not satisfy the specificity requirements of Rule 65(d) and that it would be incapable of enforcement. *See Payne [v. Travenol Labs, Inc.]*, 565 F.2d 895, 899 (5th Cir. 1978)]. In short, an injunction prohibiting the City from discriminating against the Okeechobee Center in future annexation decisions is not an available remedy to redress Appellants' alleged injuries.

Id. There are a number of Eleventh Circuit cases in accord with the holding in *City of Belle Glade*. In *Hughey v. JMS Development Corp.*, 78 F.3d 1523 (11th Cir. 1996), for example, the district court enjoined the defendant from discharging water into a stream if such a discharge would violate the Clean Water Act. The Eleventh Circuit reversed, holding that the order was an impermissible "obey the law" injunction. After discussing the requirements of Rule 65, the court reasoned:

Consistent with the two foregoing purposes, appellate courts will not countenance injunctions that merely require someone to "obey the law." *Payne v. Travenol Laboratories, Inc.*, 565 F.2d 895, 897-98 (5th Cir.), cert. denied, 439 U.S. 835, 99 S.Ct. 118, 58 L.Ed.2d 131 (1974). "Broad, non-specific language that merely enjoins a party to obey the law or comply with an agreement ... does not give the restrained party fair notice

of what conduct will risk contempt." *Epstein Family Partnership, supra*. Because of the possibility of contempt, an injunction "must be tailored to remedy the specific harms shown rather than to enjoin all possible breaches of the law." *Id.* (internal quotation marks omitted). An injunction must therefore contain "an operative command capable of 'enforcement.'" *Longshoremen's Ass'n. v. Marine Trade Ass'n.*, 389 U.S. 64, 73-74, 88 S.Ct. 201, 206-07, 19 L.Ed.2d 236, 244 (1967). See also *United States Steel Corp. v. United Mine Workers*, 598 F.2d 363, 368 (5th Cir.1979) (party subject to contempt proceeding may defend on basis that compliance was not possible).

78 F.3d at 1531.

Other federal circuit courts of appeal are in uniform accord. Early last year, the Court of Appeals for the Eight Circuit reversed a district court decree enjoining "illegal tax schemes" because the decree was both "vague and undefined." *United States v. Davidson*, No. 10-2327 (8th Cir. Jan. 31, 2011). The injunction, the Court ruled, "is also an injunction to obey the law that is overbroad under general equitable principles." *Id.* See also *United States v. Philip Morris USA Inc.*, 566 F.3d 1095 (D.C. Cir. 2009) ("we have held injunctions to be too vague when they enjoin all violations of a statute in the abstract without any further specification, or when they include, as a necessary descriptor of the forbidden conduct, an undefined term that the circumstances of the case do not clarify").

An "obey the law" injunction would also be in plain violation of Rule 65 of the Federal Rules of Civil Procedure, which governs equitable relief in federal cases. Rule 65 provides in part, "Every order granting an injunction and every restraining order shall set forth the reasons for its issuance; *shall be specific in terms*; shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained or required." (Emphasis added.) An order that simply directs the defendant to obey the law could not be less specific.

3. *No case for Disgorgement*

An order requiring Montford to “disgorge” the payment from SJK by paying the United States would also be unwarranted for many independent reasons.

(a) Disgorgement is appropriate to reverse a payment *from* the victim *to* the perpetrator; here, the payment came from SJK, the perpetrator, and was made to Montford, one of the victims. *See SEC v. Collello*, 139 F.3d 674 (9th Cir. 1998) (disgorgement applies to funds defrauding party took from victims).

(b) Division contends that disgorgement applies to the “fruit of the fraud.” But the payments from SJK were not the “fruit of the fraud” but the fruit of Montford’s labor. Division does *not* contend that Montford committed fraud by working for and receiving money from SJK. That was *not* a fraud, and the fruits of that labor are not subject to disgorgement.

(c) Disgorgement is an appropriate remedy when the amount of the money disgorged is equal to the damages caused by the receipt of the money. Here Division does not even contend that there is any relationship between the amount of money SJK paid to Montford and any damage caused by Montford’s failure to disclose the payment to his clients.

(d) The purpose of the disgorgement remedy is to protect the public. *SEC v. Cavanaugh*, 445 F.3d 105, 117 & n. 25. There has been no suggestion by staff that disgorgement will protect the public.

(e) Disgorgement may only apply to *profits* that Montford derived. Here Division is seeking the gross amount of payments Montford received. *See SEC v. Haligiannis*, 470 F. Supp.2d 373 n. 10 (rejecting the SEC’s position that it could recover gross

payments); *SEC v. Blatt*, 583 F.2d 1325, 1335; *SEC v. Amerifirst Funding, Inc.*, 2008 WL 1959843.

(f) Disgorgement is to “prevent unjust enrichment.” *SEC v. Banner Fund Int’l*, 211 F.3d 602, 617 (D.C.Cir. 2000). There is no contention whatsoever by Division that SJK’s payments to Montford unjustly enriched Montford.

In light of these authorities, and the absence of any authorities supporting Division’s position, there is no basis to “disgorge” any portion of the \$210,000.

4. *Civil Penalties*

Montford has already paid \$40,000 to settle the Investors Act case brought by St. Joes. Under the cases, that payment more than satisfies Montford’s liability for civil penalties. *See e.g., Sheer Asset Management*, 1995 CCH ¶ 85,609 (\$10,000 civil penalty, and no disgorgement, for failure to disclose payments over a three year period from broker to investment advisor of \$150,000).

This 13 day of January, 2012.



Bruce P. Brown
Georgia Bar No. 064460
Jason F. Esteves
Georgia Bar No. 276936

McKenna Long & Aldridge LLP
303 Peachtree Street, Suite 5300
Atlanta, GA 30308
(404) 527-4000
(404) 527-4198 (facsimile)